



March 18, 2019

Anne E. Misback, Secretary
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Robert E. Feldman, Executive Secretary
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Legislative and Regulatory Activities Division
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Re: Standardized Approach for Calculating the Exposure Amount of Derivative Contracts Notice of Proposed Rulemaking. Board Docket No. R-1629 and RIN 7100-AF22; FDIC RIN 3064-AE80; OCC Docket ID OCC-2018- 0030 and RIN 1557-AE44

Dear Ms. Misback, Mr. Feldman, and Legislative and Regulatory Activities Division:

IMC Chicago, LLC d/b/a IMC Financial Markets (“IMC”) greatly appreciates the opportunity to submit this letter in response to the above referenced rule making proposal (“Proposal”). IMC strongly supports the initiative to replace the current exposure methodology (“CEM”) in favor of the standardized approach for counterparty credit risk (“SA-CCR”). As an active liquidity provider and market maker in centrally cleared exchange-listed derivative products, IMC bears direct witness to the adverse impact of the artificial capital constraints imposed on bank clearing firms as a result of CEM. By more accurately reflecting risk-sensitive principles, including risk weighting and cross-product netting, SA-CCR corrects CEM’s flaws and will significantly reduce capital restraints imposed on our clearing partners. Such constraints, until addressed by SA-CCR, raise the prospect of limited liquidity during times when liquidity is needed most. Accordingly, with some limited changes identified below, IMC encourages the immediate adoption of the Proposal, including the provision that would permit regulated clearing banks to adopt SA-CCR as of the effective date of the rule.

Background

IMC is part of a global firm with approximately 600 employees worldwide and affiliates trading in Amsterdam and Sydney. IMC operates as a proprietary trading firm and registered broker-dealer, engaging in the U.S. financial markets as a bona-fide market maker and providing liquidity on nearly every listed equities and derivatives market in the United States. IMC is a Lead Market Maker in over 500 option classes and over 150 ETFs, and is one of five Designated Market Makers on the New York Stock Exchange. As such, IMC is well aware of the complexity associated with accurately managing both capital and risk.

Unfortunately, CEM employs a flawed formula to identify the capital charge for a listed-options portfolio that incorrectly measures risk and fails to account for the offsetting of deterministically-linked options positions. This failure means regulated clearing banks must maintain capital that is grossly and artificially out of proportion to the actual risk of the position they are covering. This approach particularly penalizes banks who clear market maker accounts, forcing banks to severely restrict the portfolios of their clearing clients on a per contract basis regardless of actual risk, which actually increases (rather than decreases) systemic/liquidity risk. In turn, market makers have to ration capital allocation from their clearer, arbitrarily restricting their ability to make markets and provide liquidity. Higher capital costs and arbitrary limits on capital usage are exacerbated during moments of volatility or price-dislocation events—precisely the time when flexibility and liquidity is most desired.

IMC Supports the Introduction of SA-CCR and Echoes Calls for Targeted Modifications

We agree with the Proposal that “CEM does not recognize, in an economically meaningful way, the risk reducing benefits of a balanced derivative portfolio.” IMC appreciates the Proposal’s risk-sensitive principles, which represent a significant improvement over CEM, namely delta-weighting options and netting derivatives that have economically meaningful relationships. That said, IMC echoes some concerns (and changes) identified more fully by Cboe Global Markets in its comment letter regarding this Proposal. In particular, to more immediately and more fully reverse the limitations of CEM, IMC suggests that the Proposal be amended to:

1. Permit segments of regulated banking entities, particularly those segments that provide clearing services for exchange-listed derivatives, to adopt SA-CCR early instead of requiring implementation only when a banking organization in its entirety adopts and implements SA-CCR (which may or may not be per an early adoption regime). The anticipated relief that SA-CCR will provide should not be unnecessarily delayed by, or dependent on, adoption by an entire banking entity, which could be delayed for reasons unrelated to derivatives clearing services.
2. Ensure that SA-CCR fully recognizes netting of derivatives with important, recognized, economically meaningful relationships.
 - a. We are concerned that proposed section 132(c)(9)(iv) could prevent netting of exchange-listed equity options, such as options on the S&P 500 Index (“SPX Options”), against economically offsetting exchange-listed equity futures, such as

futures on the S&P 500 Index (“S&P Futures”). This outcome strikes us as likely unintended, but if not rectified, disallowing netting of this sort does not accurately reflect the economic relationship between these products or the actual exposure of default, thereby significantly undermining the intended impact of the Proposal.

- b. We are also concerned that the Proposal may only allow partial offsetting when aggregating across distinct reference entities. This means that highly correlated products that reference the same underlying index might not be subject to full netting. For example, SPX Options and options on ETFs that track the S&P 500 Index (e.g. options on SPY) would not receive full netting, despite being considered a natural hedge. Amending the Proposal to recognize this almost perfect hedge is appropriate when contracts are technically referencing different entities but tracking the same underlying exposures. Again, absent this sort of limited modification, the Proposal risks falling short of its intended impact.

Conclusion

CEM continues to have significant adverse consequences for the exchange-listed derivatives market. Alleviating those impacts—and the increased market risk they foster—is of primary importance. For these and the foregoing reasons, IMC respectfully encourages the immediate adoption of the Proposal, together with the proposed limited modifications.

Sincerely,

A handwritten signature in blue ink, appearing to read "Andrew Stevens". The signature is fluid and cursive, with a large initial "A" and a long, sweeping tail.

Andrew Stevens
General Counsel